

PART III

Item 10. Directors and Executive Officers of the Registrant.

The current directors and executive officers of the Company are listed below. Directors and executive officers of the Company are elected to serve until they resign or are removed, are otherwise disqualified to serve or until their successors are elected and qualified.

<u>Name</u>	<u>Age</u>	<u>Position(s) with Company</u>
Edward T. Joyce	57	Chairman of the Board
Robert J. Currey	54	President, Chief Executive Officer and Director
Ronald D. Webster	50	Chief Financial Officer and Treasurer
John A. Brouse	51	Vice President Engineering
David Jacobs	36	Vice President of Customer Operations
Roxanne Jackson	34	Vice President of Human Resources
Eric D. Kurtz	35	Vice President of Operations and Assistant Secretary
Dennis Parker	62	Vice President of Marketing and Planning (Separated on January, 7, 2000)
Susan R. Quandt	45	Vice President of Sales (Separated on December 1, 1999)
Christopher Young	44	Vice President and Chief Information Officer
Michael Cloran	31	Vice President of Sales and Service
Tracy Snell	37	Vice President of Off-site Development
Howard Kitchen	57	Vice President of Telephony
Marcus Miller	45	Vice President of Marketing Management
William Farley	57	Director
Eelzie Higginbottom	58	Director
Dr. Charles E. Kaegi	49	Director
David Kronfeld	52	Director
James H. Lowry	59	Director
Glenn W. Milligan	52	Director
Thomas M. Neustatter	48	Director

Edward T. Joyce has served as a Director of the Company since the Company's inception in October 1992. Mr. Joyce founded his own firm in 1971, now known as Edward T. Joyce and Associates, P.C., a law firm dealing with commercial litigation. Mr. Joyce became Chairman of the Board of the Company as of January 1, 1999.

Robert J. Currey has served as a Director of the Company since February 1997 and was named President and Chief Operating Officer on March 1, 1998. On August 13, 1998 Mr. Currey was named the President and Chief Executive Officer of the company. Prior to joining the company, Mr. Currey served as Group President of Telecommunications Services for McLeod USA, a wholly owned subsidiary of McLeod, Inc., from September 1997 through February 1998. Mr. Currey continues to serve on the board of directors of McLeod USA. From March 1990 until September 1997, he served as President and Chief Executive Officer of Consolidated Communications. From 1988 to 1990, Mr. Currey served as Senior Vice President of Operations and Engineering at Citizens Utilities Company in Stamford, Connecticut. From 1987 to 1988, Mr. Currey served as Executive Vice President at US Sprint in Kansas City, Missouri.

Ronald D. Webster joined the Company as Chief Financial Officer in September 1997 and was named Treasurer of the company on October 13, 1998. He was previously Vice President and Treasurer at Telephone Data Systems, Inc., where he served from July 1983 until May 1987 and from April 1988 until August 1997. Prior thereto, he held executive positions with Ideal School Supply Corp. and Trans Union Corporation.

John A. Brouse has served as the Company's Vice President of Engineering since August 1998. From April 1997 until August 1998, Mr. Brouse served as Vice President of Network Operations. Prior to that

time, Mr. Brouse was Operations Engineering Director for Jones Intercable, Inc. from June 1988 to April 1997. Mr. Brouse received the cable industry's prestigious Polaris Award in 1996.

David L. Jacobs has served as the Company's Vice President of Customer Operations since July 1998. Prior to that time Mr. Jacobs was Senior Director of Engineering and Technology for Ameritech New Media and was also Ameritech's New Media Director of Technical Support and New Product Development. He held various positions with Illinois Bell prior to his appointment at Ameritech.

Roxanne Jackson has served as the Company's Vice President of Human Resources since May 1996. From January 1994 to May 1996, Ms. Jackson was the Human Resources Director for Metz Baking Group. From August 1992 until January 1994, Ms. Jackson served as the Director of Human Resources for Fox Television Stations, Inc.

Eric D. Kurtz has served as the Company's Vice President of Operations since February 1999. Previously Mr. Kurtz served as Vice President of Corporate Development and Regulatory Affairs since March 1997. From April 1989 until July 1996, Mr. Kurtz was a General Manager with Time Warner's Milwaukee & Chicago Divisions. During this time he also served as a board member of the Wisconsin Cable Communications Association and as its President from September 1994 to September 1996.

Dennis D. Parker served as the Company's Vice President of Marketing and Planning from November 1998 to December 1999. Mr. Parker served as President and CEO of Prairie Systems from 1995 until 1998; President and CEO of ITN (Illuminet) from 1989 until 1995, and was President and Managing Director of the Princeton Institute from 1985 until 1989. Prior to that, Mr. Parker was in planning and operations for AT&T Information Systems Division.

Susan R. Quandt has served as the Company's Vice President of Sales from December 1997 to December 1999. From December 1994 to December 1997, Ms. Quandt served as Executive Vice President of Taylor-Winfield, an information technology market consulting and executive recruiting firm. From January 1992 to September 1994, Ms. Quandt served as Vice President of Marketing and Product Development of Call-Net Enterprises Inc., a national long-distance telephone company owned by Sprint Canada. From January 1989 to December 1991, Ms. Quandt served as Vice President of Marketing for Schneider Communications, Inc., a regional long-distance telephone company.

Christopher Young has served as the Company's Vice President and Chief Information Officer since August of 1998. He previously held the position of CIO at Mercury Marine from 1997 until 1998. He was CIO for Siemens Electromechanical Components, Inc., from 1995 until 1997 and served as Director of Information Technology for Consolidated Communications Directories from 1990 until 1995.

Michael Cloran has served as the Company's Vice President Sales & Service since February 1999 when EnterAct, L.L.C. was acquired by the Company. From 1995 to 1999, Mr. Cloran served as CEO of EnterAct. From 1992 to 1995, Mr. Cloran was an object-oriented systems consultant developing systems including a bond trading system, medical instruments, and multimedia training systems. Prior to 1992, Mr. Cloran worked for Andersen Consulting on the Ameritech Service Center of Tomorrow project.

Tracy Snell has served as the Company's Vice President of Off-site Development since February 1999 when EnterAct, L.L.C. was acquired by the Company. From 1995 to 1999, Mr. Snell served as President of EnterAct. From 1991 to 1995, Mr. Snell developed systems for the aviation industry, HBOC, BellSouth, IBM, and multimedia training systems. Prior to 1991, Mr. Snell ran a service company and was a partner in a robotics venture.

Howard Kitchen has served as the Company's Vice President of Telephony since May 1999. Mr. Kitchen served as Director of Program Implementation from 1998 to 1999 at 21st Century. From 1997 to 1998, Mr. Kitchen served as Director of Vendor Relations at McLeod. From 1996 to 1997, Mr. Kitchen

served as Director of New Business Development at Consolidated Communication. Prior to that, Mr. Kitchen was with Michigan Bell/Ameritech in numerous operations and staff positions.

Marcus C. Miller has served as the Company's Vice President of Marketing Management since August 1998. From 1997 to 1998, Mr. Miller served as Vice President of Sales and Marketing for MD Consult, an internet based information service for doctors. From 1995 to 1997, Mr. Miller served as Executive Vice President of Marketing for Spyglass. Prior to that, Mr. Miller was Vice President and General Manager of Advanced Media Products at NEC Technologies, Inc.

William F. Farley has served as a Director of the Company since September 1998. Mr. Farley is Chairman of the Board and CEO of Farley, Inc. From 1985 to 1999, Mr. Farley was Chairman of the Board, President and CEO of Fruit of the Loom, Inc. Mr. Farley sits on various educational, civic and cultural boards including, The Horatio Alger Association Board of Directors, The Chicago Council on Foreign Relations, American Textile Manufacturers Institute, Rush Hospital Heart Institute, Lyric Opera, among others.

Eltie L. Higginbottom has served as a Director of the Company since September 1998. Mr. Higginbottom has been involved in real estate development, management, and construction of single and multi-family and commercial real estate for more than two decades. East Lake Management and Development Corporation, a firm he founded, has become one of the largest minority-owned real estate services firms in the Midwestern United States under his management. Mr. Higginbottom currently serves on the governing board of the Housing Authority of Cook County, Illinois, and the Board of Directors of Cole Taylor Bank.

Dr. Charles E. Kaegi has served as a Director of the Company since the Company's inception in October 1992. Dr. Kaegi has been in private practice of psychiatry since July 1979. He has held Medical Director positions at Ravenswood Hospital Medical Center in the Community Mental Health Center, Alcohol and Drug Abuse Program, Dual Diagnosis Program, and Partial Hospital Program. He is an Assistant Clinical Professor of Psychiatry at the University of Illinois Medical School, and in the past was an Assistant Clinical Professor of Psychiatry at Rush Medical School and a Lecturer at the Chicago Medical School.

David Kronfeld has served as a Director of the Company since February 1997. Mr. Kronfeld founded JK&B Capital in January 1996 and has been its Manager since that time. Mr. Kronfeld is a General Partner at Boston Capital Ventures where he specializes in the telecommunications and software industries. From October 1984 to August 1989, Mr. Kronfeld served as Vice President of Acquisitions and Venture Investments at Ameritech.

James H. Lowry has served as a Director of the Company since February 1997. Mr. Lowry serves as President and Chief Executive Officer of James H. Lowry & Associates ("JHLA"), a consulting company established in 1975. Prior to establishing JHLA, Mr. Lowry served as the Director of Public Service Practice for McKinsey & Company from 1967 to 1975.

Glenn W. Milligan, the Company's founder, served as Chairman of the Board until January 1, 1999 and until August 13, 1998 had been the Chief Executive Officer of the Company since its inception in October 1992. Mr. Milligan was President and Chief Executive Officer of 21st Century Technology Group, Inc. from April 1986 to October 1992. From July 1985 until March 1986, Mr. Milligan served as Regional Director for the Walt Disney Company. Mr. Milligan served as Area Manager for Showtime Networks, Inc. from March 1984 to June 1985. From July 1979 to November 1983, Mr. Milligan was the Chief Executive Officer of DAEOC, Inc., a diversified government contractor.

Thomas M. Neustaetter has served as a Director of the Company since February 1997. Since March 1999, Mr. Neustaetter has been an Executive Member of JK&B Capital, a venture capital firm. Prior to joining JK&B Capital, Mr. Neustaetter was a Partner of the Chatterjee Group, an affiliate of Soros Fund Management, from January 1996 to February 1999. Prior to working at the Chatterjee Group, Mr.

Neustaetter was the President and founder of Bancroft Capital, a general consulting firm, from December 1994 to December 1995. Mr. Neustaetter serves on the boards of directors of MGC Communications, Selectica, Inc., Gloss.com, emWare, Inc., and Vertex Holdings. Mr. Neustaetter earned his B.A. Phi Beta Kappa in Philosophy from the University of California, Berkeley, and his M.B.A. and M.S. in Information Science from University of California, Los Angeles.

Committees of the Board of Directors

The Board currently has four committees, the Executive Committee and the Compensation Committee and the Audit Committee and the Special Committee.

The Executive Committee makes recommendations to the Board of Directors regarding issues such as finance, strategic planning and long-range goals for the Company. The current members of the Executive Committee are Glenn Milligan, Edward Joyce and David Kronfeld.

The Compensation Committee reviews and recommends the compensation and bonus arrangements for executive level management of the Company and administers the Company's stock option plans. The current members of the Compensation Committee are Glenn Milligan, Edward Joyce and Thomas Neustaetter.

The Audit Committee examines and considers matters relating to the financial affairs of the Company including reviewing the Company's annual financial statements, the scope of the independent annual audit and the independent auditor's letter to management concerning the effectiveness of the Company's internal financial and accounting controls. The current members of the Audit Committee are Edward T. Joyce and Thomas Neustaetter.

The Special Committee is authorized to negotiate and execute on behalf of the Company any and all definitive agreements relating to merger with RCN Corporation. The current members are Robert J. Currey and Ronald D. Webster.

Compensation Committee Interlocks and Insider Participation

As stated above, the current members of the Compensation Committee are Messrs. Milligan, Joyce and Neustaetter. Mr. Milligan also served as the Chief Executive Officer of the Company from April 1, 1998 until December 31, 1998.

Director Compensation

Directors of the Company receive no directors' fees. Directors are reimbursed for their reasonable out-of-pocket travel expenditures incurred in connection with their service as directors.

Compensation Plan

1998 Employee Stock Option Plan. The Company's 1998 Employee Stock Option Plan (the "1998 Employee Stock Option Plan") provides for the grant of options that are not intended to qualify as "incentive stock options" under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), to employees of the Company. The Compensation Committee of the Board of Directors administers the 1998 Employee Stock Option Plan and grants options to purchase Common Stock thereunder.

On April 14, 1998, the Company's Board of Directors approved the 1998 Employee Stock Option Plan for a total of 50,000 shares of common stock to be awarded to employees of the Company. The Board of Directors allocated ungranted options from other plans during 1999 to the 1998 employee stock option plan.

The Compensation Committee has the exclusive authority to establish, amend and rescind appropriate rules and regulations relating to the Employee Stock Option Plan. Each participant's option will expire as of the earliest of: (i) the date on which it is forfeited under the provisions of the Employee Stock Option Plan; (ii) ten years from the option date; and (iii) the date on which it expires pursuant to the relevant option agreement. The option price may be greater than, less than or equal to the fair market value on the option date as determined in the sole discretion of the Compensation Committee.

An option participant may not exercise an option or any portion thereof until such option or such portion thereof has become fully vested. Pursuant to the Stock Option Plan, options generally vest 25% each year on July 1st and are fully vested after four years.

As of December 31, 1999, there were 144,298 options to acquire shares of Common Stock outstanding pursuant to the 1998 Employee Stock Option Plan, of which 7,639 were vested.

1998 Key Management Stock Option Plan. The Company's 1998 Stock Option Plan (the "1998 Key Management Stock Option Plan") provides for the grant of options that are not intended to qualify as "incentive stock options" under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), to key employees. The Compensation Committee of the Board of Directors administers the 1998 Key Management Stock Option Plan and grants options to purchase Common Stock thereunder.

On April 14, 1998, the Company's Board of Directors approved the 1998 Key Management Stock Option Plan for a total of 150,000 shares of common stock to be awarded to key management employees. On June 18, 1999 the Board of Directors voted to suspend this stock option plan. No further awards were granted and the balance of shares not awarded was allocated to one or more existing plans. The Plan shall remain in effect with respect to all outstanding awards until such time as those outstanding awards are exercised, canceled, or otherwise terminated.

The Compensation Committee has the exclusive authority to establish, amend and rescind appropriate rules and regulations relating to the Key Management Stock Option Plan. Each participant's option will expire as of the earliest of: (i) the date on which it is forfeited under the provisions of the Key Management Stock Option Plan; (ii) ten years from the option date; and (iii) the date on which it expires pursuant to the relevant option agreement. The option price may be greater than, less than or equal to the fair market value on the option date as determined in the sole discretion of the Compensation Committee.

An option participant may not exercise an option or any portion thereof until such option or such portion thereof has become fully vested. Pursuant to the Key Management Stock Option Plan, options generally vest 25% each July 1st and are fully vested after four years.

As of December 31, 1999, options to acquire 140,375 shares of Common Stock were outstanding pursuant to the 1998 Key Management Stock Option Plan, of which 56,375 were vested.

1998 Stock Option Agreement. The Company's 1998 Stock Option Agreement ("the Agreement") provides for the grant of options that are not intended to qualify as "incentive stock options" under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), to employees of the Company. The Compensation Committee of the Board of Directors administers "the Agreement" and grants options to purchase Common Stock thereunder.

On April 14, 1998, the Company's Board of Directors approved the 1998 Stock Option Agreement for a total of 331,200 shares of common stock to be awarded to two named executive officers of the Company.

The Compensation Committee has the exclusive authority to establish, amend and rescind appropriate rules and regulations relating to the Agreement. Each participant's option will expire as of the earliest of: (i) the date on which it is forfeited under the provisions of the 1988 Stock Option Agreement; (ii) ten years from the option date; and (iii) the date on which it expires pursuant to the relevant option agreement. The

option price may be greater than, less than or equal to the fair market value on the option date as determined in the sole discretion of the Compensation Committee.

An option participant may not exercise an option or any portion thereof until such option or such portion thereof has become fully vested. Pursuant to the Stock Option Plan, 139,100 options were vested immediately on August 28, 1998 and the remaining future vesting options generally vest $1/48^{\text{th}}$ each month retroactive to the date of hire and are fully vested after four years. All options have the right to become 100% vested and immediately exercisable prior to a Change in Control (as such term is defined in the Agreement).

As of December 31, 1998, options to acquire 331,200 shares of Common Stock were outstanding pursuant to the 1998 Stock Option Agreement, of which 233,770 were vested.

1997 Stock Option Plan. The Company's 1997 Stock Option Plan (the "1997 Stock Option Plan") provides for the grant of options that are not intended to qualify as "incentive stock options" under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), to key employees. The Compensation Committee of the Board of Directors administers the Stock Option Plan and grants options to purchase Common Stock thereunder.

On January 30, 1997, the Company's Board of Directors approved a stock option plan. The original, aggregate number of shares of Common Stock that may be issued under the 1997 Stock Option Plan would not exceed 728,667.7 shares. Reserved shares may be either authorized but unissued shares or treasury shares, and will be distributed at the discretion of the Board of Directors. On June 18, 1999 the Board of Directors voted to suspend this stock option plan. No further awards were granted and the balance of shares not awarded was allocated to one or more existing plans. The Plan shall remain in effect with respect to all outstanding awards until such time as those outstanding awards are exercised, canceled, or otherwise terminated.

The Compensation Committee has the exclusive authority to establish, amend and rescind appropriate rules and regulations relating to the 1997 Stock Option Plan. Each participant's option will expire as of the earliest of: (i) the date on which it is forfeited under the provisions of the Stock Option Plan; (ii) ten years from the option date; and (iii) the date on which it expires pursuant to the relevant option agreement. The option price may be greater than, less than or equal to the fair market value on the option date as determined in the sole discretion of the Compensation Committee.

An option participant may not exercise an option or any portion thereof until such option or such portion thereof has become fully vested. Pursuant to the Stock Option Plan, options generally vest $1/48^{\text{th}}$ each month and are fully vested after four years. All options become 100% vested and immediately exercisable prior to a Change in Control (as such term is defined in the Stock Option Plan).

As of December 31, 1999, options to acquire 575,759 shares of Common Stock were outstanding pursuant to the Stock Option Plan, of which 423,683 were vested.

ISP Employee Stock Option Plan. The Company's ISP Employee Stock Option Plan provides for the grant of options that are not intended to qualify as "incentive stock options" under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), to key employees. The Compensation Committee of the Board of Directors administers the ISP Employee Stock Option Plan and grants options to purchase Common Stock thereunder.

Effective February 26, 1999, the Company's Board of Directors approved the stock option plan. The aggregate number of shares of Common Stock that may be issued under options under the ISP Employee Stock Option Plan may not exceed 98,703 shares. The ISP Employee Stock Option Plan was created by the Company as a substitute for EnterAct's previous option plan.

On February 26, 1999, 98,703 shares available under the 1999 ISP Employee Stock Option Plan were awarded at an exercise price of \$4.50 which is equal to the \$4.50 fair market value determined by the Board of Directors at the time of grant.

The Compensation Committee has the exclusive authority to establish, amend and rescind appropriate rules and regulations relating to the ISP Employee Stock Option Plan. Each participant's option will expire as of the earliest of: (i) the date on which it is forfeited under the provisions of the ISP Employee Stock Option Plan; (ii) ten years from the option date; and (iii) the date on which it expires pursuant to the relevant option agreement. The option price may be greater than, less than or equal to the fair market value on the option date as determined in the sole discretion of the Compensation Committee.

An option participant may not exercise an option or any portion thereof until such option or such portion thereof has become fully vested. All options vest at 50% on the first anniversary of the original grant date, an additional 25% on the second anniversary of the original grant date, and the remaining 25% on the third anniversary of the original grant date. Certain of the grant dates are deemed to be the original grant date under the original EnterAct option plan. Depending upon the reason for termination of employment, there are specific provisions that allow the employee to exercise vested shares within 60 days of termination of employment. Options expire after ten years from the date of grant.

As of December 31, 1999, options to acquire 97,830 shares of Common Stock were outstanding; 77,572 options were vested.

1999 Stock Incentive Plan. The Company's 1999 Stock Incentive Option Plan provides for the grant of options that are not intended to qualify as "incentive stock options" under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), to key employees. The Compensation Committee of the Board of Directors administers the 1999 Stock Incentive Plan and grants options to purchase Common Stock thereunder.

Under the 1999 Stock Incentive Plan 60,000 options are available for grant primarily to specifically named former employees of EnterAct. Options granted have an exercise price of \$4.50, which was equal to the \$4.50 fair market value determined by the Board of Directors at the time of grant.

On February 26, 1999, 50,100 of the shares available under the 1999 Stock Incentive Plan were awarded to such employees with an additional 4,205 options awarded to newly hired employees of the Company in March 1999 and 2,935 options awarded to newly hired employees of the Company in April 1999.

The Compensation Committee has the exclusive authority to establish, amend and rescind appropriate rules and regulations relating to the ISP Employee Stock Option Plan. Each participant's option will expire as of the earliest of: (i) the date on which it is forfeited under the provisions of the Stock Option Plan; (ii) ten years from the option date; and (iii) the date on which it expires pursuant to the relevant option agreement. The option price may be greater than, less than or equal to the fair market value on the option date as determined in the sole discretion of the Compensation Committee.

An option participant may not exercise an option or any portion thereof until such option or such portion thereof has become fully vested. All options vest 50% on the first anniversary (February 26, 2000) of the original grant date, an additional 25% on the second anniversary of the original grant date and an additional 25% on the third anniversary of the original grant date and are therefore fully vested in three years. Depending upon the reason for termination of employment, there are specific provisions that allow the employee to exercise vested shares within 60 days of termination of employment. Options expire after ten years from the date of grant.

As of December 31, 1999, options to acquire 53,640 shares of Common Stock were outstanding pursuant to the Stock Option Plan, of which none were vested.

1999 ISP Stock Plan. The Company's 1999 Stock Incentive Plan provides for the grant of options that are not intended to qualify as "incentive stock options" under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), to employees of the Company. The Compensation Committee of the Board of Directors administers the 1999 ISP Stock Plan and grants options to purchase Common Stock thereunder.

On February 26, 1999, the Company's Board of Directors approved the 1999 ISP Stock Plan. The aggregate number of shares of Common Stock that may be issued under the Plan were 599,958. On February 26, 1999, 599,958 shares available were awarded to employees of EnterAct at various exercise prices with vesting status determined by the respective measurement dates. The series "A" option price is \$35.25 that is subject to a measurement date of the second anniversary date of the grant and expires on the seventh anniversary date of the grant. The series "B" option price is \$45.33 that is subject to a measurement date of the second anniversary date of the grant and expires on the seventh anniversary date of the grant. The series "C" option price is \$65.49 that is subject to a measurement date of the third anniversary date of the grant and expires on the eighth anniversary date of the grant. Unless terminated, all options vest at 100% on the measurement date provided the fair market value per share of the stock is equal to or greater than the exercise price per share on the measurement date. If on the measurement date the fair market value per share of the stock is less than the exercise price per share, the option shall terminate in its entirety. Depending upon the reason and timing for termination of employment, there are specific provisions that allow the employee to exercise vested shares for a period up to one year after termination of employment. Specific vesting guidelines related to change of Company control or death or disability of the employee could result in 100% vesting of options prior to the measurement dates previously stated.

The Compensation Committee has the exclusive authority to establish, amend and rescind appropriate rules and regulations relating to the 1999 ISP Stock Plan. Each participant's option will expire as of the earliest of: (i) the date on which it is forfeited under the provisions of the 1999 ISP Stock Plan; (ii) ten years from the option date; and (iii) the date on which it expires pursuant to the relevant option agreement. The option price may be greater than, less than or equal to the fair market value on the option date as determined in the sole discretion of the Compensation Committee.

As of December 31, 1999, options to acquire 599,219 shares of Common Stock were outstanding pursuant to this Plan, of which none were vested.

Robert Currey Option Plan 1999. The Company's Robert Currey Option Plan provides for the grant of options that are not intended to qualify as "incentive stock options" under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), to employees of the Company. The Compensation Committee of the Board of Directors administers the Robert Currey Stock Option Plan and grants options to purchase Common Stock thereunder.

On November 24, 1999, the Company's Board of Directors approved the stock option plan. The aggregate number of shares of Common Stock that may be issued under the Plan were 322,000. On November 24, 1999, 322,000 shares available were awarded at an exercise price of \$10.00 which is equal to the \$10.00 fair market value determined by the Board of Directors at the time of grant. Of the 322,000 shares awarded, 161,000 vested immediately.

The Compensation Committee has the exclusive authority to establish, amend and rescind appropriate rules and regulations relating to the Employee Stock Option Plan. Each participant's option will expire as of the earliest of: (i) the date on which it is forfeited under the provisions of the Employee Stock Option Plan; (ii) ten years from the option date; and (iii) the date on which it expires pursuant to the relevant option agreement. The option price may be greater than, less than or equal to the fair market value on the option date as determined in the sole discretion of the Compensation Committee.

An option participant may not exercise an option or any portion thereof until such option or such portion thereof has become fully vested. Pursuant to the Stock Option Plan, options generally vest 1/48 per month starting the month after grant date. All options become 100% vested in four years.

As of December 31, 1999, options to acquire 322,000 shares of Common Stock were outstanding pursuant to this Plan, of which 161,000 were vested.

Item 11. Executive Compensation.

Summary Compensation Table

The following table sets forth information concerning compensation of the Company's Chief Executive Officer and each executive officer of the Company whose total annual salary and bonus equaled or exceeded \$100,000 in the fiscal year (FY) ended December 31, 1999 (collectively, the "Named Executive Officers"); Compensation information for the nine month transition year (TY) ended December 31, 1998 and fiscal year (FY) ended March 31, 1998 are also included:

<u>Named Officers and Principal Position</u>	<u>Year</u>	<u>Annual Compensation</u>			<u>Long-Term Compensation Awards</u>
		<u>Salary (\$)</u>	<u>Bonus (\$)</u>	<u>Other \$(1)</u>	<u>Number Of Securities Underlying</u>
Robert J. Currey President and Chief Executive Officer	FY-1999	181,000	175,000	4,681	322,000
	TY-1998	65,133	441,346	84,418	278,200
	FY-1998	92,780	0	0	0
Glenn W. Milligan, Chairman of the Board until January 1, 1999	FY-1999	268,862	0	44,111	0
	TY-1998	179,779	25,000	6,488	27,492.2 (2)
	FY-1998	188,648	48,089	29,169	131,160.3
Ronald D. Webster Chief Financial Officer	FY-1999	166,000	184,231	0	50,000
	TY-1998	113,003	50,000	3,692	53,000
	FY-1998	92,308	50,000	3,462	109,300.2
David Jacobs Vice President of Customer Operations and Planning	FY-1999	147,969	35,815	277	0
	TY-1998	62,289	0	0	45,000
	FY-1998	0	0	0	0
Christopher Young Vice President and Chief Information Officer	FY-1999	150,000	10,815	0	15,000
	TY-1998	63,462	0	8,137	30,000
	FY-1998				
Dennis Parker Vice President of Marketing and Planning until January 7, 2000	FY-1999	150,000	10,815	3,853	0 (3)
	TY-1998	22,500	0	0	30,000
	FY-1998	0	0	0	0

- (1) Includes amounts reimbursed for relocation expenses; and in the case of Mr. Milligan, the amount includes an annual membership fee to a private club.
- (2) On December 31, 1998, the Company entered into an agreement with Glen Milligan, a Director of the Company and Chairman of the Company's Board of Directors, whereby the Company will issue 27,492.2 common shares to Mr. Milligan over a period of three years beginning August 21, 1999, or such other number of shares as is necessary to provide Mr. Milligan with .261% of the Company's common stock outstanding at August 21st of each year for the next three years. During 1999, 9,247 shares were issued to Mr. Milligan under this agreement.
- (3) Mr. Parker was the Company's Vice President of Marketing and Planning from November 1998 to January 2000. Mr. Parker left the Company in January 2000.

The following table contains certain information concerning the stock option grants made to each of the Named Executive Officers during the year ended December 31, 1999.

Option Grants in Last Fiscal Year
Individual Grants

<u>Name</u>	<u>Number of Securities Underlying Options Granted</u>	<u>% of Total Options granted to Employees in Fiscal Year</u>	<u>Exercise or Base Price (\$/Sh)</u>	<u>Market Price at Date of Grant (\$/Sh)</u>	<u>Expiration Date</u>	<u>Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term ⁽¹⁾</u>	
						<u>5%</u>	<u>10%</u>
Robert J. Currey	322,000	24.33%	\$10.00	\$10.00	11/24/09	\$5,020,253	\$8,351,851
Ronald D. Webster	50,000	3.78%	\$4.50	\$4.50	6/18/09	\$350,794	\$583,592
Christopher Young	15,000	1.13%	\$4.50	\$4.50	10/01/09	\$105,238	\$272,961

- (1) Stock options vest 1/48th each month (Currey, Milligan, and Webster) or 1/4 each year (Young) and are fully vested after four years; provided that such officer remains continuously employed by the Company.
- (2) These amounts are based on compounded annual rates of stock price appreciation of five and ten percent over the 10-year term of the options, and are mandated by rules of the Securities and Exchange Commission and are not indicative of expected stock performance. Actual gains, if any, on stock option exercises are dependent on future performance of the Common Stock, overall market conditions, as well as the option holders' continued employment throughout the vesting period. The amounts reflected in this table may not necessarily be achieved or may be exceeded. The indicated amounts are net of the option exercise price but before taxes that may be payable upon exercise.

The following table sets forth certain information regarding options to purchase Common Stock held as of December 31, 1999 by each of the Named Executive Officers. None of such Named Executive Officers exercised any options during the year ended December 31, 1999.

Aggregated Fiscal Year-End Option Values

<u>Name</u>	<u>Number of Securities Underlying Unexercised Options at Fiscal Year End</u>		<u>Value of Unexercised In-the-Money Options at Fiscal Year End ⁽¹⁾</u>	
	<u>Exercisable</u>	<u>Unexercisable</u>	<u>Exercisable</u>	<u>Unexercisable</u>
Robert J. Currey	363,853	236,436	\$3,984,464	\$2,087,152
Glenn W. Milligan	131,160	-	\$1,951,661	-
Ronald D. Webster	120,523	91,777	\$1,593,822	\$1,217,064
Christopher Young	15,000	30,000	\$172,500	\$345,000
David Jacobs	18,750	26,250	\$215,625	\$301,875
Dennis Parker	15,000	-	\$172,500	-

- (1) There was no public trading market for the Common Stock as of December 31, 1999. Accordingly, these values have been calculated by determining the difference between the estimated fair market value of the Company's Common Stock underlying the option as of December 31, 1999 (\$16.00 per

share) and the exercise price per share payable upon exercise of such options. In determining the fair market value of the Company's Common Stock, the Board of Directors considered various factors, including the Company's financial condition and business prospects, its operating results, the absence of a market for its Common Stock, and the pending merger with RCN Corporation.

Employment Agreements

Glenn W. Milligan. Mr. Milligan entered into an agreement with the Company as of January 1, 1999 with a term that ends on August 21, 2001. As of August 31, 1998, Mr. Milligan ceased to be the Chief Executive Officer of the Company and on January 1, 1999 ceased to be the Chairman of the Board. However, pursuant to the agreement, Mr. Milligan continues to be entitled to an annual base salary of \$170,000 and an annual bonus of \$100,000. Mr. Milligan is also entitled to receive annually the lesser of 20,000 shares of the Company's common stock or such other number of shares as is necessary to provide him with .261% of the outstanding shares of common stock as of August 21 of each year through August 21, 2001. Mr. Milligan can also receive stock options covering such number of shares pursuant to any separate agreement. Mr. Milligan is generally entitled to the standard executive benefits provided by the Company. In the event of his death Mr. Milligan's spouse, or his designated beneficiary, is entitled to continue to receive the benefits to which Mr. Milligan would have been entitled to under the agreement for the remainder of the term.

Robert J. Currey. Mr. Currey was employed by the Company as its President and Chief Executive Officer pursuant to an employment agreement dated March 6, 1998. Pursuant to the employment agreement Mr. Currey is entitled to an annual base salary of at least \$181,000 and an annual bonus of at least \$175,000. Mr. Currey is eligible for an annual review and at the discretion of the Board of Directors his salary can be increased but not decreased. Mr. Currey's stock option agreement dated November 24, 1999 entitled him to receive stock options for 322,000 shares of the Company's common stock, 50% of which vested immediately with the remaining "later vesting stock" to be vested over four years from the date of execution of the agreement. All options become 100% vested and immediately exercisable upon a change of control. The Board may also award a special bonus to Mr. Currey. Upon a termination of his employment agreement, Mr. Currey is generally entitled to specific severance benefits, and depending on the reason for termination, he may be entitled to \$350,000 either in lump sum or over a one year period. In addition, if prior to three years from effective date then employee receives either: (i) \$750,000 less the \$350,000 paid above or (ii) retain vested stock options.

Ronald D. Webster. Mr. Webster entered into an employment agreement with the Company as of September 1, 1998. The employment agreement will expire on January 1, 2002. Pursuant to the employment agreement, Mr. Webster is entitled to an annual base salary of \$166,000 and an annual bonus of \$50,000 on January 1, 2000. The agreement provides for Mr. Webster to receive bonus payments of \$100,000 for the remaining years. In addition, he is entitled to receive stock options covering such number of shares pursuant to a separate agreement. Upon a termination of his employment agreement, Mr. Webster is generally entitled to severance benefits, and depending on the reason for termination, he may be entitled to an amount equal to two times the annual salary and bonus he would have received for the year during which such termination occurs.

Tracy Snell. Mr. Snell entered into an employment agreement with the Company as of February 26, 1999. The employment agreement will expire on February 26, 2002. Pursuant to the employment agreement, Mr. Snell is entitled to an annual base salary of \$150,000 and is entitled to participate in any performance based bonus plan provided by the employer. In addition, he is entitled to receive stock options covering such number of shares pursuant to a separate agreement. Upon a termination of his employment, depending on the reason for termination, Mr. Snell is generally entitled to severance benefits, and he may be entitled to an amount equal to one times the annual salary and bonus he would have received for the year during which such termination occurs.

Michael Cloran. Mr. Cloran entered into an employment agreement with the Company as of February 26, 1999. The employment agreement will expire on February 26, 2002. Pursuant to the employment

agreement, Mr. Cloran is entitled to an annual base salary of \$150,000 and is entitled to participate in any performance based bonus plan provided by the employer. In addition, he is entitled to receive stock options covering such number of shares pursuant to a separate agreement. Upon a termination of his employment, depending on the reason for termination, Mr. Cloran is generally entitled to severance benefits, and he may be entitled to an amount equal to one times the annual salary and bonus he would have received for the year during which such termination occurs.

All employment agreements contain confidentiality provisions and non-compete provisions.

Item 12. Principal Shareholders.

The following table sets forth certain information at December 31, 1999, regarding beneficial ownership of the capital stock of the Company by (i) each person known by the Company to beneficially own more than 5% of the outstanding capital stock of the Company, (ii) each director of the Company, (iii) each Named Executive Officer of the Company and (iv) all directors and executive officers as a group.

<u>Name of Beneficial Owner</u>	<u>Number of Shares of Common Stock Beneficially Owned (1)</u>	<u>Number of Shares of Class A Convertible 8% Cumulative Preferred Stock Beneficially Owned(2)</u>	<u>Percent of Aggregate Voting Rights(3)</u>
Purnendu Chatterjee(4)	757,600.3	633.2	26.0%
JK&B Capital(5)	378,800.2	316.6	13.2
William Farley(6)	303,040.0	253.3	10.4
Myron M. Cherry(7)	269,625.3	12.7	5.3
Boston Capital Ventures III, L.P.(8)	151,520.1	126.6	5.3
Elske Bolitho(9)	305,000.0		5.8
Thomas Neustaetter(4)(10)	757,600.3	633.2	26.0
Charles E. Kaegi, M.D.(11)	932,480.0	6.3	17.1
Edward T. Joyce(12)	758,496.7	50.8	14.7
David Kronfeld(13)	530,320.3	443.2	18.5
Glenn W. Milligan(14)	700,685.58	4.7	13.1
James H. Lowry	19,000.0		*
Elsie Higginbottom(15)	62,816.7		1.2
Robert Currey(16)(22)	318,450		6.0
Ronald Webster(17)(22)	147,138.89	9.5	3.0
Michael Cloran(18)(22)	309,104		5.9
Tracy Snell(19)(22)	311,504		5.9
David Jacobs(20)(22)	18,750		*
Christopher Young(21)(22)	20,000		*
Dennis Parker(22)	0		*
All executive officers and directors as a group (23)	3,296,338	62,5080	20.1

* Less than 1%.

- (1) The persons named in this table have sole voting power with respect to all shares of Common Stock shown as beneficially owned by them, subject to community property laws where applicable and except as indicated in the other footnotes to this table. Beneficial ownership is determined in accordance with the rules of the SEC. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of Common Stock subject to options and warrants held by that person that are currently exercisable or exercisable within 60 days after March 15, 2000, are deemed outstanding. Such shares, however, are not deemed outstanding for the purpose of computing the percentage ownership of any other person.
- (2) Each share of Class A Convertible 8% Cumulative Preferred Stock converts into one thousand shares of Common Stock at the option of the shareholder.
- (3) Percent of Aggregate Voting Rights, for each beneficial owner, was determined based upon a fraction. The numerator of such fraction is the sum of (a) the number of outstanding shares of Common Stock beneficially owned by such owner, plus (b) the number of shares of Common Stock into which the number of shares of Class A Convertible 8% Cumulative Preferred Stock beneficially owned by such owner are convertible, plus (c) the number of shares of Common Stock issuable upon

exercise of options and warrants beneficially owned by such owner and which are exercisable within 60 days of March 15, 2000. The denominator of such fraction is the sum of (a) the aggregate number of shares of Common Stock outstanding on March 15, 2000, plus (b) the number of shares of Common Stock into which the aggregate number of shares of Class A Convertible 8% Cumulative Preferred Stock outstanding on March 15, 2000 are convertible, plus (c) the aggregate number of shares of Common Stock issuable upon exercise of options and warrants beneficially owned by such owner and which are exercisable within 60 days of March 15, 2000.

- (4) Represents 112,445.2 shares of Common Stock, 266,354.9 shares of Common Stock issuable upon exercise of warrants and 316.6 shares of Class A Convertible 8% Cumulative Preferred Stock held by Quantum Industrial Partners LDC ("QIP"). The address of QIP is c/o Curacao Corporation Company, Kaya Flamboyen 9, Willemstad, Curacao, Netherlands Antilles. Also includes 65,218.2 shares of Common Stock, 154,485.9 shares of Common Stock issuable upon exercise of warrants and 183.6 shares of Class A Convertible 8% Cumulative Preferred Stock held by S-C Phoenix Holdings, L.L.C. ("S-C Phoenix"). The address of S-C Phoenix is c/o Chatterjee Management Company, 888 Seventh Avenue, New York, New York 10106. This total also includes 45.2 shares of Class A Convertible 8% Cumulative Preferred Stock, 16,057.2 shares of Common Stock and 38,035.5 shares of Common Stock issuable upon exercise of warrants held by Winston Partners II, LLC and 87.8 shares of Class A Convertible 8% Cumulative Preferred Stock, 31,169.8 shares of Common Stock and 73,833.6 shares of Common Stock issuable upon exercise of warrants held by Winston Partners II, LDC (Winston Partners II, LLC and Winston Partners II, LDC, collectively "Winston Partners"). The address of Winston Partners II, LLC is c/o Chatterjee Management Company, 888 Seventh Avenue, New York, New York 10106. The address of Winston Partners II, LDC is c/o Curacao Corporation Company, Kaya Flamboyen 9, Willemstad, Curacao, Netherlands Antilles. QIP, S-C Phoenix and Winston Partners are associated with Chatterjee Management Company. Chatterjee Management Company is managed and controlled by Purnendu Chatterjee. Dr. Chatterjee may be deemed to have the power to direct the voting and disposition of the shares owned by QIP, S-C Phoenix and Winston Partners. Dr. Chatterjee and Mr. George Soros may each be deemed to have the power to direct the voting and disposition of the shares owned by S-C Phoenix. In addition, Mr. Soros, Mr. Stanley F. Druckenmiller and Soros Fund Management LLC may be deemed to have the power to direct the voting and disposition of the shares owned by QIP. The Percent of Aggregate Voting Rights excludes 224,890.4 shares of non-voting Common Stock beneficially owned by Purnendu Chatterjee.
- (5) Represents 221.6 shares of Class A Convertible 8% Cumulative Preferred Stock, 78,711.6 shares of Common Stock and 186,448.5 shares of Common Stock issuable upon exercise of warrants held by JK&B Capital, L.P. and 95.0 shares of Class A Convertible 8% Cumulative Preferred Stock, 33,733.6 shares of Common Stock and 79,906.5 shares of Common Stock issuable upon exercise of warrants held by JK&B Capital II, L.P. (JK&B Capital, L.P. and JK&B Capital II, L.P., collectively "JK&B Capital"). The address of JK&B Capital is 205 North Michigan, Suite 808, Chicago, IL 60601. The Percent of Aggregate Voting Rights excludes up to 112,445.2 shares of non-voting Common Stock beneficially owned by JK&B Capital.
- (6) The Percent of Aggregate Voting Rights excludes 89,956.1 shares of non-voting Common Stock. Mr. Farley disclaims beneficial ownership of all shares of non-voting common stock except 26,237.2 shares. The address of Mr. Farley is 233 South Wacker Drive, 5000 Sears Tower, Chicago, Illinois, 60606.
- (7) Includes 90,000 shares of Common Stock owned by Patricia M. Cherry, Trustee, Cherry Family Trust UTA May 11, 1995. Also includes 72,223.3 shares of Common Stock issuable upon exercise of options. The address of Mr. Cherry is 30 North LaSalle, #2300, Chicago, Illinois 60602. The Percent of Aggregate Voting Rights excludes 4,497.8 shares of non-voting Common Stock beneficially owned by Mr. Cherry.
- (8) Includes 106,542.0 shares of Common Stock issuable upon exercise of warrants. The address of Boston Capital Ventures III, L.P. is Old City Hall, 45 School Street, Boston, MA 02108. The Percent

of Aggregate Voting Rights excludes 44,978.1 shares of non-voting Common Stock beneficially owned by Boston Capital Ventures III, L.P.

- (9) Represents 153,000 shares of Common Stock held by Elske Bolitho, Trustee of Robert W. Bolitho Trust, and 152,000 shares of Common Stock held by Elske Bolitho, Trustee of Elske Bolitho Trust. The address of Ms. Bolitho is 13376 185th Place N, Jupiter, Florida 33478.
- (10) All of such shares are beneficially owned by Purnendu Chatterjee. Mr. Neustaetter is an officer of the Chatterjee Management Group, a division of Chatterjee Management Company. Mr. Neustaetter is an officer of Chatterjee Management Company. Mr. Neustaetter disclaims beneficial ownership of these shares, over which he does not have dispositive or voting control. The business address of Mr. Neustaetter is c/o Chatterjee Management Company, 888 Seventh Avenue, New York, NY 10106.
- (11) Includes 172,202.2 shares of Common Stock held by Charles E. Kaegi, M.D., S.C., Defined Contribution Pension Plan and Trust, 26,990.0 shares of Common Stock held by Charles E. Kaegi, M.D., S.C., Defined Benefit Pension Plan and Trust, 1,700.0 shares of Common Stock held by Charles E. Kaegi, M.D., S.C. Profit Sharing Pension Plan and Trust, 115,754.5 shares of Common Stock, 3.2 shares of Class A Convertible 8% Cumulative Preferred Stock and 2,663.5 shares of Common Stock issuable upon exercise of warrants held by Charles E. Kaegi, MD Declaration of Trust dated 11-22-97 and 2,570.0 shares of Common Stock held by Charles E. Kaegi IRA. Also includes 104,000.0 shares of Common Stock and 376,721.8 shares of common stock issuable upon exercise of options held jointly with Mr. Kaegi's wife, and 109,744.5 shares of Common Stock and 3.2 shares of Class A Convertible 8% Cumulative Preferred Stock held by Wendy L. Kaegi Declaration of Trust dated 11-22-97 and 17,470 shares of Common Stock held by Wendy L. Kaegi, IRA. The Percent of Aggregate Voting Rights excludes 2,248.9 shares of non-voting Common Stock held by Mr. Kaegi and 1,124.5 shares of non-voting stock held by Wendy L. Kaegi Declaration of Trust dated 11-22-97.
- (12) Includes 269,516.5 shares of Common Stock issuable upon exercise of options held by Mr. Joyce, 96,620.0 shares of Common Stock and 52,291.5 shares of Common Stock issuable upon exercise of options held by Mr. Joyce's wife, 28,500 shares of Common Stock issuable upon exercise of warrants held by Mr. Joyce, 4,587 shares of Common Stock, 12.9 shares of Class A Convertible 8% Cumulative Preferred Stock and 10,867.3 shares of Common Stock issuable upon exercise of warrants held by Edward T. Joyce, as Trustee of the Edward T. Joyce Ltd. Employees' Profit Sharing Plan, and 1,439.3 shares of Common Stock and 4.1 shares of Convertible Class A Preferred Stock and 3,409.3 shares of Common Stock issuable upon exercise of warrants held by Edward T. Joyce, as Trustee of the Individual Retirement Account for Edward T. Joyce. The Percent of Aggregate Voting Rights excludes 18,058.7 shares of non-voting Common Stock beneficially owned by Mr. Joyce.
- (13) All such shares are held of record by JK&B Capital and Boston Capital Ventures III, L.P. Mr. Kronfeld is a Manager of JK&B Management, L.L.C. a General Partner of JK&B Capital, L.P. and JK&B Capital II, L.P. Mr. Kronfeld is General Partner of Boston Ventures III, L.P. The business address of Mr. Kronfeld is c/o JK&B Capital, 205 North Michigan, Suite 808, Chicago, IL 60601.
- (14) Includes 316,160.3 shares of Common Stock issuable upon exercise of options and 3995.3 shares of Common Stock issuable upon exercise of Warrants held by Mr. Milligan. Also includes 243,750 shares of Common Stock and 61,225.5 shares of Common Stock issuable upon exercise of options held by Mr. Milligan's wife. The Percent of Aggregate Voting Rights excludes 1,686.7 shares of non-voting Common Stock beneficially owned by Mr. Milligan.
- (15) Includes 24,816.7 shares of Common Stock issuable upon exercise of options.
- (16) Includes 318,450 of Common Stock issuable upon exercise of options.

- (17) Includes 142,606.33 Common Stock issuable upon exercise of options and 7990.6 shares of Common Stock issuable upon exercise of Warrants. Also includes 3165.5 shares of Common Stock and 8.9 shares of Class A Convertible 8% Cumulative Preferred Stock held by LaSalle National Bank, as custodian for Ron Webster IRA Rollover. The Percent of Aggregate Voting Rights excludes 3165.5 shares of non-voting Common Stock.
- (18) Includes 152,248.0 shares of Common Stock held by Mr. Cloran's wife and 3,750 shares of Common Stock issuable upon exercise of options held by Mr. Cloran.
- (19) Includes 154,448.0 shares of Common Stock held by Mr. Snell's wife and 3,750 shares of Common Stock issuable upon exercise of options held by Mr. Snell.
- (20) Includes 18,750 shares of Common Stock issuable upon exercise of options.
- (21) Includes 20,000 shares of Common Stock issuable upon exercise of options.
- (22) The address of each such person is c/o the Company, 350 N. Orleans Street, Suite 600, Chicago, IL 60654.
- (23) Includes the aggregate of 1,289,688.3 shares of Common Stock issuable upon exercise of options and 20,302.995 shares of Common Stock issuable upon exercise of warrants. See notes 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20 and 21 above. The Percent of Aggregate Voting Rights excludes 407,682.6 shares of non-voting Common Stock.

Item 13. Certain Relationships and Related Transactions.

Sale of Capital Stock

In April 1998, pursuant to a Purchase, Joinder & Waiver Agreement, the Company issued 6.3316 shares of Class A Convertible 8% Cumulative Preferred Stock at a price of \$15,793.84 per share and warrants to purchase 5,327.1 shares of Common Stock at a price of \$.000001 per share to an investor. In addition, 2,248.9 shares of voting common stock and 2,248.9 shares of non-voting common stock were issued in conjunction with this sale.

The Company believes that the transaction set forth above was made on terms no less favorable to the Company than would have been obtained from unaffiliated third parties. The Company has adopted a policy whereby all future transactions between the Company and its officers, directors and affiliates will be on terms no less favorable to the Company than could be obtained from unrelated third parties and were approved by a majority of the disinterested members of the Board of Directors.

PART IV

Item 14. Exhibits, Consolidated Financial Statement Schedules and Reports on Form 8-K.

(a) Financial Exhibits, Financial Statement Schedule and Exhibits:

1. Financial Statements

- Report of Independent Public Accountants
- Consolidated Balance Sheets as of December 31, 1999 and December 31, 1998.
- Consolidated Statements of Income for the year ended December 31, 1999, the nine months ended December 31, 1998, and the year ended March 31, 1998.
- Consolidated Statements of Changes in Shareholders' Equity for the twelve months ended December 31, 1999, the nine months ended December 31, 1998, and the twelve months ended March 31, 1998.
- Consolidated Statements of Cash Flows for the twelve months ended December 31, 1999, the nine months ended December 31, 1998, and the twelve months ended March 31, 1998.
- Notes to Consolidated Financial Statements

2. Financial Statement Schedule

The following schedule, for which provision is made in the applicable accounting regulations of the Securities Exchange Commission and is thereby required is filed herewith:

Schedule II – 21st Century Telecom Group, Inc. – Consolidated Valuation and Qualifying Accounts for the years ended December 31, 1999 and 1998.

All other schedules are omitted because they are not applicable, immaterial or the required information is included in the Consolidated Financial Statements on notes thereto.

(b) Reports on Form 8-K:

On Current Report Form 8-K, dated December 12, 1999, under "Item 5. Other Events." and "Item 7. Financial Statements and Exhibits", the Company announced a definitive merger agreement with RCN Corporation and filed a copy of the Merger Agreement in its most recent filing with the Securities and Exchange Commission (SEC).

1. Exhibits

Exhibits listed in the Exhibit Index are filed with this report or incorporated by reference therein.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of

21st Century Telecom Group, Inc.:

We have audited the accompanying consolidated balance sheets of 21st Century Telecom Group, Inc. (the "Company") (an Illinois corporation) and subsidiaries as of December 31, 1999 and December 31, 1998, and the related consolidated statements of operations, cash flows and shareholders' equity for the year ended December 31, 1999, the nine months ended December 31, 1998, and the twelve months ended March 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of 21st Century Telecom Group, Inc. and subsidiaries for the year ended December 31, 1999, the nine months ended December 31, 1998, and the twelve months ended March 31, 1998, in conformity with accounting principles generally accepted in the United States.

The accompanying statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 13 to the financial statements, the Company has experienced recurring losses from operations and has a net capital deficiency that raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 13. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Our audits are made for the purpose of forming an opinion on the basic financial statements taken as a whole. The financial statement schedule included in Item 14(a)(2) is presented for purposes of complying with the Securities and Exchange Commission's rules and is not a required part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

Arthur Andersen LLP

Chicago, Illinois
March 14, 2000

21st CENTURY TELECOM GROUP, INC.
CONSOLIDATED BALANCE SHEETS

<u>ASSETS</u>	<u>December 31, 1999</u>	<u>December 31, 1998</u>
Current Assets		
Cash and cash equivalents	\$ 10,332,386	\$ 72,901,622
Accounts receivable, less allowances of \$472,188 and \$1,376, respectively	1,220,929	157,082
Short term investments	17,655,227	98,464,936
Inventory	19,303,501	10,385,575
Prepaid expenses and other	770,709	598,878
Total current assets	<u>49,282,752</u>	<u>182,508,093</u>
Property, Plant and Equipment		
Leasehold improvements	10,515,653	5,647,709
Property, plant and equipment	170,736,029	57,475,153
Less: accumulated depreciation	<u>(15,659,781)</u>	<u>(4,814,143)</u>
Property, plant and equipment, net	165,591,901	58,308,719
Other Assets		
Restricted cash collateral reserve	4,089,496	1,796,880
Prepaid franchise fees	3,715,807	3,685,961
Debt issuance costs, net of amortization of \$2,966,311 and \$1,386,138, respectively	5,020,932	6,601,105
Deferred franchise costs, net of amortization of \$811,065 and \$623,681, respectively	258,066	350,144
Bank commitment fee, net of amortization of \$285,904 and \$78,604, respectively	691,002	898,302
Deferred mapping and design, net of amortization of \$149,226 and \$93,071, respectively	83,122	44,880
Goodwill, net of amortization of \$864,053	9,603,603	-
Other deferred costs	<u>169,727</u>	<u>149,889</u>
Total other assets	23,631,755	13,527,161
Total assets	<u>\$ 238,506,408</u>	<u>\$ 254,343,973</u>
<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>		
Current Liabilities		
Accounts payable	\$ 20,703,909	\$ 10,688,242
Accrued severance	1,277,072	1,230,000
Notes payable	2,000,000	-
Accrued expenses and other	<u>2,347,023</u>	<u>1,261,982</u>
Total current liabilities	26,328,004	13,180,224
Senior discount notes, net of discount of \$112,597,267 and \$140,681,223, respectively	250,537,733	222,453,777
Notes payable	2,000,000	-
Other long term obligations	<u>2,472,842</u>	<u>-</u>
Total noncurrent liabilities	255,010,575	222,453,777
Total liabilities	281,338,579	235,634,001
Redeemable Preferred Stock		
13 3/4% senior cumulative exchangeable preferred stock, \$.01 par value 63,485.88 and 55,458.12 shares outstanding, respectively	61,666,268	52,617,006
Shareholders' Equity		
Class A convertible 8% cumulative preferred stock, no par value	28,626,168	24,611,966
Voting and non-voting common stock	11,433,920	7,862,836
Common shares to be issued	81,821	123,432
Retained deficit	<u>(144,640,348)</u>	<u>(66,505,268)</u>
Total shareholders' equity	(104,498,439)	(33,907,034)
Total liabilities and shareholders' equity	<u>\$ 238,506,408</u>	<u>\$ 254,343,973</u>

See accompanying Notes to the Consolidated Financial Statements.

21st CENTURY TELECOM GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	<u>For the Year Ended December 31, 1999</u>	<u>For the Nine Months Ended December 31, 1998</u>	<u>For the Year Ended March 31, 1998</u>
Operating revenues	\$ 11,320,134	\$ 873,898	\$ 189,023
Operating expenses			
Network operations	11,849,414	2,678,047	2,023,310
Sales and marketing	9,923,165	3,533,731	2,213,723
General and administrative	20,959,037	12,812,019	8,003,196
Depreciation and amortization	11,972,805	3,876,779	1,411,847
Total operating expenses	<u>54,704,421</u>	<u>22,900,576</u>	<u>13,652,076</u>
Operating loss	(43,384,287)	(22,026,678)	(13,463,053)
Other (income) expense			
Interest expense	25,893,790	18,232,959	3,722,947
Interest income	(5,851,369)	(8,670,695)	(2,373,867)
Amortization of debt issuance costs	1,591,667	1,199,770	218,411
Other (income) expense	53,241	-	-
Total other (income) expense	<u>21,687,329</u>	<u>10,762,034</u>	<u>1,567,491</u>
Net loss	(65,071,616)	(32,788,712)	(15,030,544)
Preferred stock requirements	<u>(13,063,465)</u>	<u>(8,928,707)</u>	<u>(4,234,463)</u>
Net loss attributable to common shares	<u>\$ (78,135,081)</u>	<u>\$ (41,717,419)</u>	<u>\$ (19,265,007)</u>
Weighted average common shares outstanding	4,126,826.1	3,493,836.5	2,615,061.0
Basic and diluted loss per share	<u>\$ (18.93)</u>	<u>\$ (11.94)</u>	<u>\$ (7.37)</u>

See accompanying Notes to the Consolidated Financial Statements.

21st CENTURY TELECOM GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Year Ended December 31, 1999	For the Nine Months Ended December 31, 1998	For the Year Ended March 31, 1998
Operating Activities			
Net loss	\$ (65,071,616)	\$ (32,788,712)	\$ (15,030,544)
Adjustments to reconcile net loss to net cash used for operating activities:			
Depreciation and amortization	11,972,805	3,876,779	1,411,847
Amortization of debt discount	28,083,956	18,975,760	3,478,017
Amortization of debt issuance costs	1,591,668	1,199,770	218,411
Stock compensation	422,322	843,789	1,004,776
Common stock to be issued	-	123,432	-
Changes in operating assets and liabilities:			
Receivables, net	(720,105)	(146,723)	103,121
Other current assets	(9,079,768)	(8,982,612)	(2,299,723)
Accounts payable	10,135,573	(274,621)	3,154,912
Accrued expenses and other current liabilities	264,238	963,330	-
Noncurrent assets and liabilities, net	(3,292,390)	(1,308,343)	(121,333)
Net Cash Used for Operating Activities	<u>\$ (25,693,317)</u>	<u>\$ (17,518,151)</u>	<u>\$ (8,080,516)</u>
Investing Activities			
(Purchases) sales/maturities of short term investments, net	80,809,709	(88,464,936)	(10,000,000)
Acquisition, net of cash acquired	(2,653,914)	-	-
Capital expenditures	(117,678,927)	(38,305,421)	(15,665,047)
Net Cash Used for Investing Activities	<u>\$ (39,523,132)</u>	<u>\$ (126,770,357)</u>	<u>\$ (25,665,047)</u>
Financing Activities			
Payable to bank	-	(419,068)	419,068
Proceeds from senior discount notes	-	-	200,000,000
Issuance costs related to senior discount notes	-	-	(7,886,825)
Proceeds from issuance of exchangeable preferred stock, net of issuance costs	-	-	48,025,236
Payments on debentures	-	(131,040)	-
Proceeds from issuance of class A preferred stock, net of issuance costs	-	100,000	2,597,380
Issuance of common stock	151,341	-	-
Repurchase of Options	(183,194)	-	-
Proceeds from Leases	2,679,066	-	-
Net Cash Provided by (Used For) Financing Activities	<u>\$ 2,647,213</u>	<u>\$ (450,108)</u>	<u>\$ 243,154,859</u>
Increase (Decrease) in Cash and Cash Equivalents	(62,569,236)	(144,738,616)	209,409,296
Cash and Cash Equivalents at Beginning of Period	72,901,622	217,640,238	8,230,942
Cash and Cash Equivalents at End of Period	<u>\$ 10,332,386</u>	<u>\$ 72,901,622</u>	<u>\$ 217,640,238</u>

See accompanying Notes to the Consolidated Financial Statements.

21ST CENTURY TELECOM GROUP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE TWELVE MONTHS ENDED DECEMBER 31, 1999, NINE MONTHS ENDED DECEMBER 31, 1998, AND
THE TWELVE MONTHS ENDED MARCH 31, 1998

	Total	Common Stock	Common Shares to be Issued	Class A Preferred Stock	Retained Deficit	Unearned Compensation	Common Shares	Common Shares to be Issued	Common Share Warrants	Class A Preferred Shares
Balances, March 31, 1997	\$ (2,960,337)	\$ 2,565,604	\$	\$	\$ (5,522,830)	\$ (3,111)	2,374,343.6	\$	1,161,307.6	\$
Net loss	(15,030,544)				(15,030,544)					
Reclassification of Class A preferred stock to permanent equity	16,794,963			16,794,963						1,380.3
Stock issuances	2,597,380			2,597,380						168.2
Exchange of initial and debt warrants for voting and non voting common shares							1,100,724.4			
Accrued preferred stock dividends	(973,958)			1,872,892	(2,846,850)					
Preferred stock accretion	(87,014)			1,300,633	(1,387,647)					
Class A preferred stock proceeds allocated to related common share warrants		825,037		(825,037)					141,561.3	
Class A preferred stock issuance costs allocated to related common share warrants		(10,834)		10,834						
Exchangeable Preferred Stock proceeds allocated to related common shares warrants	2,700,000	2,700,000							438,870.0	
Exchangeable Preferred stock issuance costs allocated to related common share warrants	(106,636)	(106,636)								
Stock option accrual	972,865	972,865								
Stock compensation	28,800	28,800					14,399.9			
Amortization of unearned compensation	3,111					3,111				
Balances, March 31, 1998	3,938,630	6,974,836		21,751,665	(24,787,871)	-	3,489,467.9	-	1,741,738.9	1,548.5
Net loss	(32,788,712)				(32,788,712)					
Stock issuances	223,432	44,211	123,432	55,789			4,497.8	27,429.2	5,327.1	6.3
Accrued preferred stock dividends	(5,437,332)			1,620,938	(7,058,270)					
Preferred stock accretion	(686,841)			1,183,574	(1,870,415)					
Stock options	843,789	843,789								
Balances, December 31, 1998	(33,907,034)	7,862,836	123,432	24,611,966	(66,505,268)	-	3,493,965.7	27,429.2	1,747,066.0	1,554.8
Net loss	(65,071,616)				(65,071,616)					
Stock Issued for EnterAct acquisition	3,136,473	3,136,473					696,994.0			
Stock issuances	153,872	153,872					41,706.8			
Accrued preferred stock dividends	(8,165,748)			2,311,890	(10,477,638)					
Preferred stock accretion	(883,514)			1,702,312	(2,585,826)					
Issuance of shares to be issued		41,611	(41,611)				9,247.0	(9,247.0)		
Stock options	422,322	422,322								
Repurchase of options	(183,194)	(183,194)								
Balances, December 31, 1999	\$ (104,498,439)	\$ 11,433,920	\$ 81,821	\$ 28,626,168	\$ (144,640,348)	\$ -	4,241,913.5	18,182.2	1,747,066.0	1,554.8

See accompanying Notes to the Consolidated Financial Statements.

21st CENTURY TELECOM GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Consolidation and Presentation

21st Century Telecom Group, Inc. ("21st Century" or the "Company") is a Chicago-based company incorporated in October 1992. 21st Century is an integrated, facilities-based communications company, which seeks to be the first provider of bundled voice, video and high-speed Internet and data services in selected midwestern markets beginning with Chicago's Area 1. The City of Chicago has awarded the Company a 15-year renewable franchise for Area 1. Area 1 stretches more than 16 miles along Chicago's densely populated lakefront skyline including the nation's second largest business and financial district.

It is management's belief that the Company operates as one reportable operating segment that contains many shared expenses generated by the Company's various revenue streams. Any segment allocation of shared expenses incurred on a single network to multiple revenue streams would be impractical and arbitrary; furthermore, the Company currently does not make such allocations internally.

The Company's accounting and reporting principles conform to generally accepted accounting principles. The consolidated financial statements include all wholly-owned subsidiaries. There have been no significant intercompany billing transactions or activities within or between these subsidiaries through December 31, 1999.

Cash and Cash Equivalents

Cash and cash equivalents at December 31, 1999 and December 31, 1998 consist of cash on hand at certain banks, as well as investments with maturities of 90 days or less. The investments are stated at cost, which approximates market value. All investments were purchased in accordance with debt restrictions.

Receivables

Receivables are reflected at their net realizable value.

Short Term Investments

Short term investments are held to maturity and are stated at cost which approximates market value. At December 31, 1999 and December 31, 1998, short term investments consisted of time deposit accounts, certificates of deposit and money market deposits, with fixed rates of interest all with maturities of less than one year. These investments were purchased in accordance with debt restrictions.

Inventories

Inventory consists primarily of converters, modems and materials that will be requisitioned for use in constructing the Company's network and is stated at the lower of average cost or market.

Property, Plant and Equipment

Property, plant and equipment are stated at cost including labor and overhead costs associated with construction. Cost includes capitalized interest on funds borrowed to finance construction. Capitalized interest for the twelve months ended December 31, 1999 and the nine months ended December 31, 1998 was \$2,207,147 and \$780,680, respectively. Depreciation on property, plant and equipment was computed by applying the straight-line method over the estimated service lives for depreciable plant and equipment.

Repairs of all property, plant and equipment and minor replacements and renewals are charged to expense as incurred. Major replacements and betterments are capitalized. Leasehold improvements are depreciated on a straight-line basis over the term of the lease.

The lives of depreciable property, plant and equipment range from 3 to 15 years. Effective July 1, 1998, the estimated service lives for hub sites and outside plant were changed from 7 to 13 years. In addition, the estimated service lives for certain software and furniture and fixtures were changed from 5 to 7 years. These changes were made to correspond to industry norms for these types of assets. These changes in depreciable lives resulted in a reduction of depreciation expense of approximately \$1,200,000 for the nine months ended December 31, 1998.

Deferred Franchise Costs

The Company has deferred franchise costs, including legal costs, associated with obtaining the franchises from the City of Chicago and the Villages of Skokie and Northbrook. Deferred franchise costs for the City of Chicago and the Village of Skokie are being amortized over five years.

Deferred Mapping and Design Costs

The Company has deferred certain mapping and design costs associated with strand mapping the Area 1 region within the City of Chicago and the Village of Skokie region. Deferred mapping and design costs are being amortized over three years.

Debt Issuance Costs

Costs associated with the issuance of the Company's debt securities (see Note 5) have been capitalized and are being amortized using the effective interest rate method.

Advertising Costs

The Company expenses the cost of advertising as incurred. Advertising expense for the year ended December 31, 1999 and the nine months ended December 31, 1998 was \$2,533,140 and \$1,270,592, respectively. The Company did not incur significant advertising costs for year ended March 31, 1998.

Revenue Recognition

The Company recognizes voice, video, Internet and data revenues as services are provided to subscribers.

Accounting for Stock-Based Compensation

The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," for disclosure purposes. However, it continues to recognize compensation cost based on Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." See Note 9 for the disclosures required by SFAS No. 123.

Comprehensive Income

The Company has no items that are subject to SFAS No. 130, "Reporting Comprehensive Income".

Goodwill

As a result of the February 26, 1999 acquisition of EnterAct, the Company recognized \$10,467,656 of goodwill. Goodwill is being amortized over ten years.

Earnings Per Share

Basic per share amounts were based on weighted average common shares outstanding, excluding common stock equivalents, of 4,126,826.1 for the year ended December 31, 1999, 3,493,836.5 for the nine months ended December 31, 1998, and 2,615,061.0 for the year ended March 31, 1998. Given the anti-dilutive effect of including common stock equivalents in the calculation, diluted earnings per share amounts are not presented.

At December 31, 1999, common stock equivalents included: (1) 1,308,196 common share warrants related to the Class A Convertible 8% Cumulative Preferred Stock, (2) 438,870 common share warrants related to 13 1/4% Senior Cumulative Exchangeable Preferred Stock, (3) 1,250,000 options issued in connection with certain Directors' guarantee of a loan, (4) 959,768.6 vested employee stock options, and (5) 18,994.7 common share warrants issued to a financial advisor. The net loss attributable to common shares on which the basic earning per share calculation is based, reflects the net loss increased by the amount of preferred dividends and accretion related to the Class A Convertible 8% Cumulative Preferred Stock and 13 1/4% Senior Cumulative Exchangeable Preferred Stock.

At December 31, 1998, common stock equivalents included: (1) 1,308,196 common share warrants related to the Class A Convertible 8% Cumulative Preferred Stock, (2) 438,870 common share warrants related to 13 1/4% Senior Cumulative Exchangeable Preferred Stock, (3) 1,250,000 options issued in connection with certain Directors' guarantee of a loan, (4) 575,766.8 vested employee stock options, and (5) 18,994.7 common share warrants issued to a financial advisor. The net loss attributable to common shares on which the basic earning per share calculation is based, reflects the net loss increased by the amount of preferred dividends and accretion related to the Class A Convertible 8% Cumulative Preferred Stock and 13 1/4% Senior Cumulative Exchangeable Preferred Stock.

At March 31, 1998, these common stock equivalents included the following: (1) 1,302,868.9 common share warrants related to the Class A Convertible 8% Cumulative Preferred Stock, (2) 438,870 common share warrants related to 13 1/4% Senior Cumulative Exchangeable Preferred Stock, (3) 1,250,000 options issued in connection with certain Directors' guarantee of a loan, (4) 287,829.9 employee vested stock options, and (5) 18,994.7 common share warrants issued to a financial advisor. The net loss attributable to common shares on which the basic earnings per share calculation is based, reflects the net loss increased by the amount of preferred dividends and accretion related to the Class A Convertible 8% Cumulative Preferred Stock and 13 1/4% Senior Cumulative Exchangeable Preferred Stock.

Cash Flow Information

For the year ended December 31, 1999, the nine months ended December 31, 1998, and the year ended March 31, 1998, the Company has not paid any federal or state income taxes. For the year ended December 31, 1999, the nine months ended December 31, 1998, and the year ended March 31, 1998, the Company paid \$88,562, \$131,040 and \$193,922, respectively, in interest.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Long-Lived Assets

The Company periodically reviews the values assigned to long-lived assets such as property, plant and equipment and identifiable intangibles to determine whether any impairments are other than temporary. If

the impairment is permanent, a loss is recognized. No impairment losses have been recognized by the Company.

Disclosure of Fair Value of Financial Instruments

The carrying amount reported in the balance sheets for cash and cash equivalents, accounts receivable, short term investments, accounts payable and other current liabilities approximates fair value because of the short-term maturity of these financial instruments. The carrying amount reported in the balance sheets for the 12¼% Senior Discount Notes approximates fair value.

Reclassifications

Certain prior year balances have been reclassified to conform with the current year presentation.

2. Property, Plant and Equipment

The components of property, plant and equipment follow:

	December 31, 1999	December 31, 1998	Estimated life (years)
Transmission and distribution systems	\$142,519,864	\$40,831,723	3 - 13
Leasehold improvements	10,515,653	5,647,709	15
Furniture and fixtures / Other Equipment	9,158,050	6,000,386	3 - 7
Capitalized Leases	3,298,071	-	2-4
Construction in progress	15,760,044	10,643,044	N/A
Property, plant and equipment, at cost	\$181,251,682	\$63,122,862	
Less: accumulated depreciation	(15,659,781)	(4,814,143)	
Net property, plant and equipment	\$165,591,901	\$58,308,719	

Depreciation expense charged to operations for the twelve months ended December 31, 1999, nine months ended December 31, 1998 and twelve months ended March 31, 1998 was \$11,108,752, \$3,629,017 and \$1,186,302, respectively. Pertaining to capitalized leases, accumulated depreciation at December 31, 1999 was \$846,628.

3. Prepaid Franchise Fees

The Company was required to prepay \$3,000,000 of franchise fees within 120 days of being awarded the franchise by the City of Chicago. In accordance with the franchise agreement, the prepaid franchise fees earn interest for the period outstanding at a rate equal to the Company's cost of borrowed funds. The borrowing rate of the Company, at the time of the prepayment, was 10%. The interest accrued on the prepaid franchise fees for the year ended December 31, 1999, nine months ended December 31, 1998 and the year ended March 31, 1998 amounted to \$300,000, \$226,027 and \$299,994, respectively. These prepaid franchise fees are reduced as revenues are billed to customers.

4. Acquisition of Business

On February 26, 1999, the Company acquired EnterAct, L.L.C. ("EnterAct"), a Chicago-based provider of Internet access and commercial data services. EnterAct had approximately 50 employees. The majority of EnterAct's approximately 10,000 customers were residential dial up Internet access customers; however, a significant portion of EnterAct's 1998 calendar year revenues were derived from Internet, data and consulting services provided to its business customer base. The Company issued 696,944 shares of its no par value common stock valued by the Company at \$4.50 per share to certain officers of EnterAct and agreed to pay an additional \$6,500,000. The Company paid \$2,500,000 at the closing and issued two non-interest bearing notes totaling \$4 million. The notes are payable to executives of EnterAct over two years,

one half due on the first anniversary date and one half due on the second anniversary date. This acquisition was accounted for as a purchase and accordingly the purchased assets and assumed liabilities have been recorded at their fair market values at the date of acquisition. The purchase price exceeded the estimated fair market value of the net assets acquired resulting in goodwill in the amount of \$10,467,656, which is being amortized using the straight line method over 10 years. In addition, stock option plans were approved and options were awarded to certain employees of EnterAct. EnterAct became the Company's Business Services Group, developing, marketing and selling data and telephony services to the business community.

Since the acquisition of EnterAct was accounted for as a purchase its results of operations have been included with the Company's since the date of acquisition. Had the Company reflected the acquisition as of the beginning of each applicable period, its revenues would have increased approximately \$710,000, \$2,185,000, and \$1,458,000 for the period ended December 31, 1999, the nine months ended December 31, 1998, and the year ended March 31, 1998. All other reportable supplemental pro forma information would not be materially different than the reported amounts.

5. Debt

A summary of debt outstanding at December 31, 1999 and December 31, 1998, is as follows:

	December 31, 1999	December 31, 1998
Notes Payable pursuant to EnterAct Acquisition, due 2000	\$2,000,000	-
Notes Payable pursuant to EnterAct Acquisition, due 2001	2,000,000	-
Capitalized Leases and Other Long-term Debt	2,472,842	-
Convertible Subordinated Debentures, Series 2, 25%, due 1999	-	28,849
12 1/4% Senior Discount Notes Due 2008	250,537,733	222,453,777
Total Debt	\$257,010,575	\$222,482,626
Less: Current Portion	(2,000,000)	(28,849)
Total Long Term Debt	\$255,010,575	\$222,453,777

Capitalized Leases

Starting in 1999, the Company entered into capital leases to purchase vehicles for its fleet. The terms of the leases vary from two to four years. At December 31, 1999, the Company owed principle payments of \$2,120,596. The company acquired certain leases for computer equipment through the acquisition of EnterAct. The leases come due at various times in 2,000 and 2,001. At December 31, 1999, the Company owed \$352,246 pertaining to these leases.

Convertible Subordinated Debentures

Prior to February 1, 1997, all subordinated debentures were convertible to common stock based on a conversion ratio of \$2 to 1 share of common stock.

During the three months ended September 30, 1998, the convertible subordinated debentures, Series 1, at 25% interest, due 1998 in the amount of \$52,702 plus accrued interest was paid. In addition, the convertible subordinated debentures, Series 2, at 25% interest, due 1999 in the amount of \$28,849 was reclassified from long term debt to short term debt and is included in accrued expenses and other in the Consolidated Balance Sheet at December 31, 1998.

12 1/4% Senior Discount Notes Due 2008

On February 9, 1998, the Company issued \$363,135,000 of 12 1/4% Senior Discount Notes due 2008 (the "Notes"). The proceeds from the issue were \$200,000,000 which represent a yield to maturity on the Notes of 12 1/4% (computed on a semi-annual bond equivalent basis). The discount and issuance costs are being amortized through February 15, 2003 using the effective interest rate method. Thereafter, cash interest accrues until the notes mature in 2008. For the year ended December 31, 1999 and the nine months ended December 31, 1998, the amortized discount totaled \$28,083,956 and \$18,975,760, respectively. Issuance costs for the transaction totaled \$7,886,825. The amount of amortization recognized for the year ended December 31, 1999, the nine months ended December 31, 1998, and the year ended March 31, 1998 were \$1,591,667, \$1,199,770, and \$218,411 respectively. The notes are unsecured obligations.

The Notes are redeemable at the Company's option in whole or part, on February 15, 2003, 2004 and 2005, at a redemption price of 106.1250, 104.0833 and 102.0417, respectively and at the principal amount thereafter. In addition, the Company has the right to redeem up to 1/3 of the Notes with the proceeds of an initial public offering. The redemption price would also include accrued interest earned through the date of redemption.

Upon a change of control, each holder of Notes may require the Company to purchase all or any portion of such holder's Notes at a purchase price equal to 101% of the Accreted Value thereof plus accrued and unpaid interest, if any, to the date of purchase. Accreted value means, as of any date, the amount for each \$1,000 principal amount at maturity of the Senior Discount Notes as specified in the terms of the Notes.

The Notes include certain restrictive covenants relating to, among other things, limitations on additional indebtedness, payment of dividends, investment options, asset sales, liens on assets and mergers and consolidations. The Company is in compliance with the covenants at December 31, 1999.

Bank Revolving Credit Facility

On August 5, 1998, the Company entered into a revolving credit facility with a number of banks for an aggregate amount of \$40,000,000. As of December 31, 1999, no borrowings have been made under this facility. In connection with the initiation of its bank revolving credit facility, as of December 31, 1998, the Company incurred \$976,906 in bank commitment fees and other related costs, which are being amortized on a straight-line basis over its five year term.

The credit facility contains general and financial covenants that place certain restrictions on the Company. On October 30, 1998 and November 3, 1999, the Company entered into Amendment No. 1 and Amendment No. 2 respectively, to its bank revolving credit facility which adjusted certain operating covenants. The Company is limited with respect to: the incurrence of certain liens; the sale of assets under certain circumstances; permitting any subsidiary distribution restrictions; certain consolidations; mergers and transfers; and the use of loan proceeds.

6. Class A Convertible 8% Cumulative Preferred Stock

	Preferred Shares	Amount
March 31, 1997	1,380.3	\$16,794,963
Stock issuance	168.2	1,783,177
Accrued dividends		1,872,892
Accretion		1,300,633
March 31, 1998	1,548.5	\$21,751,665
Stock issuance	6.3	55,789
Accrued dividends	—	1,620,938
Accretion	—	1,183,574
December 31, 1998	1,554.8	\$24,611,966
Accrued dividends	—	2,311,890
Accretion	—	1,702,312
December 31, 1999	<u>1,554.8</u>	<u>\$28,626,168</u>

On January 30, 1997 several investors contracted with the Company to purchase 1,380.3 shares of the Company's Class A Convertible 8% Cumulative Preferred Stock and initial, secondary and debt warrants for a purchase price of \$15,793.84 per share, totaling \$21.8 million. A portion of the initial purchase price was allocated to the common share warrants. The allocation was based on the market value of the common stock at the date of the sale of the Class A Convertible 8% Cumulative Preferred Stock and the number of related secondary warrants, initial warrants and debt warrants associated with such preferred stock. The fair market value of the common stock at the date of the sale was estimated to be \$2 per share. The number of secondary warrants associated with the initial purchase amounted to 1,161,307.6. The number of initial and debt warrants associated with the initial purchase was based on the number of voting and non-voting common shares that these warrants were replaced with as a result of a subsequent amendment to the related stock purchase agreement as discussed below. These initial and debt warrants were replaced with 1,000,966.8 shares of voting and non-voting common stock. This allocation resulted in \$4,324,549 and \$17,475,451 being recorded as common stock and redeemable preferred stock, respectively, at March 31, 1997. Issuance costs of \$1,446,396 were incurred in conjunction with the sale of the Class A Convertible 8% Cumulative Preferred Stock. These issuance costs were allocated between the Class A Convertible 8% Cumulative Preferred Stock and the related warrants based on the relative portions of the proceeds allocated to each. The carrying value of the Class A Convertible 8% Cumulative Preferred Stock is being accreted to its redemption value (using the effective interest method) over the four year period from the date of the original preferred stock purchase agreement to the date the stock becomes mandatorily redeemable under the original agreement or the date at which the Class A preferred shareholders can compel sale of the Company under the amended agreement, both dates being January 30, 2001. The Class A convertible 8% Cumulative Preferred Stock is recorded on the balance sheet at the allocated portion of the purchase price paid by investors, less the allocated portion of the issuance costs, plus accrued and unpaid preferred stock dividends, plus accretion. At March 31, 1997, certain of the provisions of the agreement were as follows:

- Each preferred share is convertible into one thousand common shares.
- Dividends accrue daily on the aggregate amount paid at an annual rate of 8%. Unpaid dividends compound on a semi-annual basis on June 30 and December 31. At the consummation of a qualified public offering, all accrued and unpaid dividends would be converted into common stock without the issuance of additional shares. A qualified public offering is one in which (1) the public purchases at least \$25 million of common stock, (2) the price per share paid is at least twice the liquidation value per share of the Class A Convertible 8% Cumulative Preferred Stock, (3) the common stock is traded on a national exchange or The Nasdaq Stock Market, and (4) the shares issued and sold represent at least 20% of the common stock outstanding after the public offering.

- Upon consummation of a qualified public offering, all preferred shares are required to be converted into common shares.
- At any time after the fourth anniversary of the date of the purchase and before the earlier of the date of the consummation of a qualified public offering or the seventh anniversary of the date of the purchase, each holder of the stock has the right from time to time to require the Company to repurchase all, but not less than all, of their shares held (the put arrangement). The shares would be repurchased by the Company for the greater of: (1) the purchase price paid by the holder of the stock, plus all accrued and unpaid dividends, or (2) the market value of the shares.
- "Initial Warrants" were granted to the investors who may increase their ownership percentage up to another 12%. These warrants expire on May 31, 2008. The warrants are exercisable at \$.000001 per share of common stock only if the Company does not meet certain pre-established performance indicators. The Company had until May 31, 1998 to meet these performance indicators.
- "Secondary Warrants" to purchase up to 1,331,774.8 shares of common stock at \$.000001 per share of common stock were also granted to the investors. These secondary warrants expire on January 30, 2007.
- "Debt Warrants", in addition to the initial and secondary warrants discussed above, will vest to the new investors if the Company does not receive Board of Director approval by July 31, 1997, for a \$50 million senior debt financing arrangement. Under this provision the Company is to issue warrants to purchase shares representing 2% of the outstanding common stock on the first day of each month until the definitive document with respect to such debt is in place. Any such warrants issued would expire ten years from the date of issue. Any debt warrants would also be exercisable at \$.000001 per share of common stock.

During December 1997, the Company and its Class A Convertible 8% Cumulative Preferred Stock shareholders negotiated a number of changes to the original Stock Purchase Agreement. These changes were formally ratified on January 8 and 14, 1998. The original put arrangement as discussed above was removed and was replaced by the right of the Class A preferred shareholders to require the sale of the Company. The new provision provides that at any time and from time to time after the fourth anniversary of the date of issuance of the senior discount notes and senior cumulative exchangeable preferred stock and ending on the earlier to occur of the consummation of a qualified public offering and the seventh anniversary of the date of issuance of the senior discount notes, the Class A preferred shareholders have the right to require the sale of the Company. The liquidation value of the preferred stock is the sum of the original cost plus any accrued and unpaid dividends. The right to obtain additional common shares under the initial warrant and debt warrant provisions as discussed above was removed and was replaced by an agreement to increase the Class A preferred shareholders ownership on a fully diluted basis by an additional 8% by issuing additional common stock. One-half of this additional stock is voting and the other half is non-voting. A portion of the proceeds and issuance costs associated with the sale of the Class A Convertible 8% Cumulative Preferred stock were allocated to the initial and debt warrants and reflected in common stock at March 31, 1997.

In addition, the holders of the Class A preferred stock are collectively in a position to control the taking of many significant corporate actions by the Company, including the making of any significant capital commitments, the incurrence of any significant indebtedness, merger and the payment of dividends on the common stock, pursuant to agreements which provide that prior to taking such actions, the Company will need to obtain the approval of the nominees to the Board of Directors of the holders of the Class A preferred stock. These rights have been modified by the covenants related to the 12 1/4% Senior Discount Notes (see Note 5).

Of the \$21.8 million for the related January 30, 1997 sale, \$21.7 million was received by March 31, 1997, with the remainder received by April 22, 1997. The purchase resulted in the preferred shareholders having an approximate 37% ownership interest in the Company on a fully diluted basis excluding the

contingently issuable common shares from the exercise of the initial warrants and the debt warrants. The proceeds from this preferred stock offering were used to (1) repay a \$5 million revolving credit note to LaSalle Northwest National Bank, (2) purchase the subscriber base of a related party located in the Chicago franchise area for \$3,381,300, (3) retire existing Company debt and accounts payable in the amount of \$541,166, and (4) pay transaction costs of \$1,446,396. The balance of the proceeds were used for working capital and capital expenditures to build the network, operating center and network infrastructure.

On September 23, November 20, 1997 and January 20, 1998, several investors contracted with the Company to purchase 63.3, 9.5 and 95.4 shares, respectively, of the Company's Class A Convertible 8% Cumulative Preferred Stock and initial, secondary and debt warrants for a purchase price of \$15,793.84 per share, totaling approximately \$2.6 million. A portion of the initial purchase price was allocated to the common share warrants. The allocation was based on the market value of the common stock at the date of the sale of the Class A Convertible 8% Cumulative Preferred Stock and the number of related secondary, initial and debt warrants associated with such preferred stock. The fair market value of the common stock at the date of the sale was estimated to be \$2 per share for the September 23 and November 20, 1997 sales and \$4.50 per share for the January 20, 1998 sale. The number of secondary warrants associated with the three purchases amounted to 53,271, 7,990, and 80,300, respectively. The number of initial and debt warrants associated with the three purchases was based on the number of voting and non-voting common shares that these warrants were replaced with as a result of the amendment to the related stock purchase agreement as discussed above. These initial and debt warrants were replaced with 37,009, 6,089 and 56,660 shares of voting and non-voting common stock, respectively. This allocation resulted in \$180,561, \$28,158 and \$616,318 being recorded as common stock on the three sales dates, respectively and \$819,439, \$121,842 and \$891,062 being recorded as Class A preferred stock on the three sales dates, respectively. Issuance costs of \$60,000 were incurred in conjunction with the sale of the Class A Convertible 8% Cumulative Preferred Stock on September 23, 1997. These issuance costs were allocated between the Class A Convertible 8% Cumulative Preferred Stock and the related warrants based on the relative portions of the proceeds allocated to each. The purchases were based on the same terms as those previously mentioned for the \$21.8 million preferred stock issuance.

In April 1998, pursuant to a Purchase, Joinder & Waiver Agreement, the Company agreed to issue 6.3316 shares of Class A Convertible 8% Cumulative Preferred Stock at a price of \$15,793.84 per share and warrants to purchase 5,327.1 shares of Common Stock at a price of \$.000001 per share to an investor.

7. 13 1/4 % Senior Cumulative Exchangeable Preferred Stock

	Preferred Shares	Amount
February 9, 1998		
Proceeds	50,000	\$ 47,300,000
Issuance costs	—	(1,868,126)
Accrued dividends	—	973,924
Accretion	—	87,014
March 31, 1998	50,000	\$ 46,492,812
Accrued dividends	—	5,437,353
Accretion	—	686,841
Stock dividends	5,458.12	—
December 31, 1998	55,458.12	\$ 52,617,006
Accrued Dividends	—	8,165,748
Accretion	—	883,514
Stock dividends	8,027.76	—
December 31, 1999	<u>63,485.88</u>	<u>\$61,666,268</u>

On February 9, 1998, 50,000 shares of 13¼% Senior Cumulative Exchangeable Preferred Stock Due 2010 and related common share warrants were issued. The net proceeds received were \$48,025,236. The Exchangeable Preferred Stock will rank senior to all other classes of equity securities of the Company.

The value of the 438,870 common stock warrants issued, \$2,605,000, has been allocated to common shareholders' equity, (see Note 8).

The carrying value of the 13¼% Senior Cumulative Exchangeable Preferred Stock is being accreted to its redemption value (using the effective interest method) over the five year period from the date of issue to the date the stock first becomes redeemable, February 15, 2003. The 13¼% Senior Cumulative Exchangeable Preferred Stock is recorded on the balance sheet at the allocated portion of the purchase price paid by investors, less the allocated portion of the issuance costs, plus accrued and unpaid dividends, plus accretion.

On or prior to February 15, 2001, the Company may redeem in whole but not in part, the outstanding Exchangeable Preferred Stock at a redemption price of 113 ¼% of the liquidation preference (\$1,000 per share) plus accumulated unpaid dividends to date of redemption with the net proceeds of an Equity Offering. An equity offering means either (a) an underwritten primary public offering of common stock of the Company pursuant to an effective registration statement under the Securities Act or (b) a primary offering of capital stock (other than disqualified stock) of the Company to one or more persons primarily engaged in a related business. On February 15, 2003, 2004, 2005 and 2006 (and thereafter), at a redemption price of 106.8750%, 104.5833%, 102.2917% and 100%, respectively, of the liquidation preference (\$1,000 per share) plus accumulated unpaid dividends, the Exchangeable Preferred Stock may be redeemed in whole, or in part, at the Company's option. On February 15, 2010, the Exchangeable Preferred Stock is mandatorily redeemable.

In the event of a change of control, the Company shall offer to purchase all outstanding shares of Exchangeable Preferred Stock, in whole or in part, at a purchase price equal to 101% of the aggregate liquidation preference (\$1,000 per share) thereof, plus accumulated and unpaid dividends, if any to the date of purchase.

Dividends are payable quarterly on February 15, May 15, August 15 and November 15. Dividends are payable in cash except that on or prior to February 15, 2003, dividends may be paid by the issuance of additional shares of Exchangeable Preferred Stock at the Company's option.

On February 15, May 17, August 16, and October 12, 1999 the Company issued 1,906.37, 1,971.9, 2,039.69, 2,109.8 respectively, of additional shares of Exchangeable Preferred Stock as the quarterly dividends on the 13 ¼% Senior Cumulative Preferred Stock due 2010. On May 15, August 17, and November 16, 1998, the Company issued 1,833.3, 1,781.8 and 1,843.02, respectively, of additional shares of Exchangeable Preferred Stock as the quarterly dividends on the 13 ¼ % Senior Cumulative Exchangeable Preferred Stock Due 2010.

The restrictive covenants related to the Exchangeable Preferred Stock are similar to those indicated for the 12¼% Senior Debenture Notes as discussed in Note 5. The Company is in compliance with these covenants at December 31, 1999.

8. Common Shares

On January 9, 1998, the common shareholders approved an amendment to the Articles of Incorporation to increase the number of authorized common shares to 50,000,000 from 1,000,000. On the same date, the directors of the Company declared a 1,000 for 1 share split of the Company's issued and outstanding common shares. All common share amounts and per share amounts have been restated to reflect this amendment and related split.